THE REVIEW OF
BANKING & FINANCIAL SERVICES
A PERIODIC REVIEW OF SPECIAL LEGAL DEVELOPMENTS AFFECTING LENDING AND OTHER FINANCIAL INSTITUTIONS

Vol. 38 No. 9 September 2022

MANAGING FAIR LENDING RISK IN THE DIGITAL AGE

The growing use of innovations in machine learning, artificial intelligence ("AI"), and alternative data are raising new fair lending risks for lenders. The authors address such risks, beginning with the use of the data, followed by an overview of fair lending laws and enforcement. They then turn to protocols for lenders to carefully consider to avoid fair lending violations when developing and using AI/machine learning models that use alternative data.

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Innovations in machine learning, artificial intelligence ("AI"), and alternative data are changing the fintech landscape by expanding access to credit to previously underserved communities and reducing friction in applications for, and the marketing, underwriting, and funding of loan transactions. But, at the same time, federal regulators like the Consumer Financial Protection Bureau ("CFPB"), the Department of Justice ("DOJ"), the Department of Housing and Urban Development ("HUD"), and the federal banking regulators are increasingly skeptical that these technologies are being used and developed in accordance with anti-discrimination laws like the Equal Credit Opportunity Act ("ECOA") and the Fair Housing Act ("FHA"), which the Biden Administration has made a top priority. While regulators generally recognize that using AI and alternative data can increase consumer access to credit products and more favorable pricing and terms, they have also specifically called out risk in algorithmic underwriting and the target marketing of credit applicants. Regulators have expressed concerns that these technologies may exclude protected classes and they continue to ramp up efforts to address practices that exclude protected class borrowers or otherwise have discriminatory effects.

In light of the increased use of AI and alternative data across different functions in the credit market — and the emphasis on fair lending enforcement by the CFPB, the DOJ, and other regulators — AI and alternative data have faced increased scrutiny. This article will explain some of the fair lending risks associated with these automated decisioning models and provide a high-level risk mitigation strategy for their users.

USE OF AI AND ALTERNATIVE DATA

As noted, the use of more automated decisioning algorithms and alternative data can benefit consumers and fintechs alike by expanding access to credit. According to a CFPB study, by year 2010 some 26 million consumers in the United States were "credit invisible" according to traditional scoring systems based on income, payment history, current debts, credit utilization ratio, number of open accounts, and length of

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